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Japan Reduces Its Discount Rate

On January 30 the Bank of Japan · lowered the official discount rate 0.5 percentage point to 4.5 percent in an effort to expand domestic demand. The discount rate, the rate the central bank charges on loans to commercial banks, had been set at 5 percent since October 1983. Despite the bank's action, the yen continued to appreciate, reaching the Y190=$1.00 level on February 3.

trade deficit of $148.5 billion, as well as Finance Minister Noboru Takeshita's statements that Japanese industry could live with the yen at the 190 level. There was also speculation that the United States would in fact cut its discount rate.

Randall S. Jones

Reagan Proposes Study Of Exchange Market Stability

President Reagan, in his State of the Union address, directed Treasury Secretary James Baker to study the feasibility of a worldwide conference on the international monetary system and report back to him by the end of the year. Mr. Reagan said he favored removing "some volatility" from the current exchange-rate system. Although Mr. Baker expressed willingness last April to consider such a conference, the presidential directive will add momentum to the push for reform of the international monetary system.

The president's statements illustrate the shift in the administration's stance on exchange rates. During its first term, the Reagan administration supported the floating exchange rates and rejected intervention except in cases of "disorderly markets." At the September Group of Five meeting, however, the United States agreed the dollar was overvalued and pledged to intervene in exchange markets to lower its value. The president's request to Mr. Baker indicates a willingness to consider reforms to the current international monetary system.

On Capitol Hill there have been some proposals for reform of the international monetary system, notably by presidential aspirant Jack Kemp (R, N.Y.). It is unlikely, though, that the administration is ready to propose a return to fixed exchange rates or a system of target zones, which establishes bands in which currencies move against each other. One important objective of the president's proposal is to demonstrate the White House's recognition that volatile currency swings are an important issue and to assuage American industry, which has been hurt by the high dollar. In addition to fighting protectionism, the administration hopes to see a further gradual decline of the dollar.

It is unclear how much international support there is for reform of the present exchange-rate system. Although the Treasury secretary believes that there is growing support for more stable exchange rates, an April 1985 report by the eleven-largest industrial countries suggested few changes in the current system.

Randall S. Jones

Japan's 1985 Balance Of Payments Sets New Records

According to preliminary Ministry of Finance figures, Japan's balance of payments figures recorded several new highs and lows in 1985 (see Table). Perhaps most troubling to Japanese policymakers is the continued rise of the nation's trade and current account surpluses despite drastically slowed export growth. On the other hand, Japan is very actively recycling this bounty as indicated by the record net long-term capital outflow.

Japan's Global Balance of Payments

(in millions dollars, IMF value basis, seasonally unadjusted)

	1981	1982	1983	1984	1985*
Exports (f.o.b.)	$149,552	$137,663	$145,468	$168,290	$173,928
	(18.0%)	(-7.9%)	(5.7%)	(15.7%)	(3.4%)
Imports (f.o.b.)	129,555	119,584	114,014	124,033	117,926
	(4.0)	(-7.7)	(-4.9)	(8.8)	(-4.9)
Trade Balance	19,967	18,079	31,454	44,257	56,002
Services	-13,573	-9,848	-9,106	-7,747	-5,075
	(-19.6)	(27.4)	(8.0)	(14.9)	(-34.5)
Transfers	-1,624	-1,381	-1,549	-1,507	-1,656
	(-6.3)	(15.0)	(-13.5)	(2.7)	(-9.9)
Current Account Balance	4,770	6,850	20,799	35,003	49,271
Long-Term Capital	-9,672	-14,969	-17,700	-49,651	-64,807
	(-516.2)	(-54.8)	(-18.9)	(-180.5)	(-30.5)
Basic Balance	-4,902	-8,119	3,099	-14,648	-15,536
Short-Term Capital	2,265	-1,579	23	-4,295	-660
	(-27.9)	(-169.7)	(111.1)	(-18,773.9)	(84.6)
Errors & Omissions	493	4,727	2,055	3,743	3,878
Overall Balance	-2,144	-4,971	5,177	-15,200	-12,318

*Preliminary figures.

Note: Figures in parentheses are percentage changes from previous year.

For the second year in a row, the margin between the value of exports and imports increased by about $12 billion dollars, pushing the surplus to new heights. Weakening commodity prices combined with continued strong demand for Japanese goods depressed the value of imports and drove up the value of exports. The impact of the yen's rise during the second half of the year was not enough to counteract first-half gains. (Exports in yen terms rose 3 percent in 1985 compared with 3.4 percent in dollar terms.)

Japan's deficit in services trade continued to narrow during 1985, indicating improving international competitiveness in this area. While rapidly escalating investment income is responsible for the majority of the narrowing, it is not clear if this trend will continue in the coming years. Due to new opportunities in Japan's liberalized telecommunications and financial markets, possible improvements in market access in the legal field and in air and sea transportation services, foreigners' chances to capitalize on their expertise on Japanese turf may improve. For now, however, the result of a rising trade surplus and shrinking services deficit is a record current account surplus.

Nineteen hundred eighty-five will be remembered as the year Japan became the world's top creditor nation and the United States became a net debtor nation. This is underscored by Japan's record net long-term capital outflow.

MOF estimates that Japanese bought $291.3 billion worth of foreign bonds while selling $237.9 billion abroad for a deficit in bond sales of $53.5 billion. The previous record set in 1984 was $26.8 billion when purchases totaled $56.4 billion and sales amounted to $29.6 billion. In December's equity markets, Japanese investors also were net buyers of foreign stocks (by $226 million) and net sellers in their own markets (by $125 million), indicating strong interest in foreign financial instruments. As a result, an average $5 billion-a-month net torrent of funds out of the country easily dwarfed the current account balance surplus and kept the country's overall balance in the red for the year.

Jon Choy

Japan's Oil Appetite Continues To Shrink

Japanese officials are pointing to lower crude oil prices as a major cause of reduced imports in 1985, on both a customs clearance (see JEI Report No. 4B, January 31, 1986) and a balance of payments basis (see article in this issue). Not only has the price of oil been declining, but Japan's absolute imports of various products have also been shrinking.

The Ministry of International Trade and Industry reports that Japan imported 7.6 percent less crude oil during 1985, a total of 198.3 million kiloliters. By diversifying its sources, Tokyo has reduced the share bought from the Organization of Petroleum Exporting Countries to 73.3 percent from 77.7 percent the previous year. The biggest loser among OPEC countries was Saudi Arabia. Possibly because of Saudi refusal to discount its oil, purchases by Japan sank 40.9 percent to just 34.5 million kiloliters. Shipments from the United Arab Emirates jumped 29 percent to 42.2 million kiloliters, partially compensating for the Saudi loss. Imports from other countries were mixed. Purchases of Indonesian crude fell 19.7 percent to 22.6 million kiloliters, while those from nearby Malaysia rose 3.3 percent to 6.6 million kiloliters.

Import price trends clearly show the impact of the strengthening yen as well as falling global prices (see Table). In terms of dollars per barrel, prices declined steadily over the first six months of 1985 and have since held steady. In yen terms, however, prices have entered a free fall that is likely to continue at least until the yen-dollar exchange rate stabilizes.

The price Japan pays may show even steeper declines in 1986 for two reasons. First, OPEC will continue its efforts to regain market share through price reductions, undoubtedly pushing down the price of non-OPEC oil as well. Spot market prices have already fallen far below the $28 dollar-a-barrel for Saudi Arabia's benchmark Arabian Light. Second, OPEC is negotiating "netback" contracts with European and Japanese customers, promising even greater savings. Under this arrangement, oil producers refund the cost of shipping the crude to customers and part of the refining costs. Saudi Arabia has already signed such contracts with European buyers, yielding a price of approximately $19.80 a barrel. The OPEC linchpin has also sealed pacts with three Japanese firms. Kyodo Oil Co., Ltd. will purchase 70,000 barrels a day over the next six months; Marubeni Corp. will take delivery of around 50,000 barrels a day; and Mitsubishi Corp. has agreed to 100,000 barrels a day for the same period.

Although the Japanese have not announced the actual prices, analysts expect them to be about 50-60 cents a barrel above European levels because of greater transportation costs.

The economic impact of these reductions may not be as great as one might expect. Although Japan is almost completely reliant on foreign sources of energy, conservation and diversification programs have decreased the impact of oil prices on the economy. The political effects may actually be greater than the economic ones. If Japan's total import bill continues to fall because of cheaper oil, it could widen the country's global trade surplus and heighten trade tensions. While such a situation could hardly be blamed on the Japanese, Congress is not always swayed by rational arguments.

Jon Choy

Japan's 1985 Imports of Crude Oil

	Volume (1,000 bbl)	Import Bill ($1,000,000)	Dollars per Barrel	Yen per Kiloliter
January	99,017	$2,881	$29.10	Y46,379
February	113,471	3,258	28.71	46,352
March	126,586	3,583	28.30	46,379
April	108,206	3,067	28.34	45,371
May	101,389	2,871	28.32	44,769
June	74,297	2,107	28.36	44,636
July	89,997	2,511	27.90	43,213
August	91,029	2,497	27.43	41,045
September	95,073	2,602	27.37	41,173
October	109,415	2,991	27.34	38,073
November	97,004	2,687	27.70	36,468
December	115,169	3,217	27.93	35,590
1984 Total	1,341,034	39,379	29.36*	43,713*
1985 Total	1,220,653	34,272	28.07*	38,589*

*Average annual prices.

Sources: Ministries of Finance and International Trade and Industry

Ministers Urge Wider Japanese Role In International Community

Sounding a familiar theme, Prime Minister Yasuhiro Nakasone, Foreign Minister Shintaro Abe and Finance Minister Noboru Takeshita all called upon Japan to assume a role in the international arena commensurate with its economic prowess at the opening session of the Diet January 27. Each minister essentially underscored consistency in current policies, with an emphasis on expanding those policies to reflect a greater Japanese global role.

The prime minister emphasized his continued commitments to regional defense, the internationalization of the yen, wider market opening measures to enable overseas partners to sell more products in Japan, and restructuring the

domestic economy to bring it in line with international standards. While vague in certain areas -- particularly on the domestic economic issues -- he nevertheless indicated that the thrust of policies initiated during the first three years of his administration would be continued. For example, he emphasized fulfilling the goals of the national defense plan in a manner consistent with the country's conventional limitations, although he avoided specific reference to limiting total defense spending to one percent of the country's gross national product.

Foreign Minister Abe continued this tone, noting the importance of recent developments in improving ties with the Soviet Union, China, Southeast Asia and South Korea. Some observers suggested that this prominent mention of Asian nations suggested a shift in Tokyo's priorities in foreign affairs, but it was more likely an indication that Japan is indeed assuming -- slowly but surely -- a greater international role. Policymakers have made a conscious effort over the past three years to broaden contacts with nations that have often accused Tokyo of paying little attention to them. In addition, Mr. Abe emphasized his personal commitment to expanding Japan's role in international aid and relief programs and said that the Japan-U.S. relationship remained the cornerstone of Japan's foreign policy planning.

While focusing more heavily on domestic economic issues, Mr. Takeshita reiterated the prime minister's commitment to yen internationalization and expanded on his plans to re-structure the domestic economy through tax reform. The finance minister implied that the subject would be a major issue in the current session of the Diet, although legislation is not expected until next summer at the earliest. If overseas observers were looking for hints of domestic stimulus, there were few to be found; Mr. Takeshita consistently emphasized continued fiscal austerity to bring budget deficits under control.

The speeches contained few surprises, but in several respects were reassuring. Japan's allies will know what to expect from Tokyo in the months to come. While this may suggest continued frictions on the trade front, it represents Japan's commitment to move in the direction it sees as proper in the international trading system. Calls for further international cooperation in monetary talks, a multilateral trade negotiating round and intense discussions in the upcoming Tokyo summit -- a major policy priority for Japan -- reflect this momentum and the consensus among Japan's leadership. The question is whether Tokyo's pace will satisfy its partners in the West and in Asia.

Michael W. Chinworth

Japan's Foreign Policy Puts Renewed Focus On Asia, Improved Ties With ASEAN

Japanese officials have declared a renewed foreign policy emphasis on the Asian-Pacific region. In a speech to the Diet and during a meeting with business leaders January 27, Foreign Minister Shintaro Abe underlined the importance of Japan's ties with its Asian neighbors. In a statement reminiscent of the language of the Fukuda Doctrine, he declared that "Our relations with the Asia-Pacific countries have recently taken on new depth and breadth and I intend to promote a foreign policy emphasizing not just relations between countries but also the bonds between people and the warmth of heart-to-heart encounters."

Mr. Abe placed particular importance on ties between Japan and the six member states of the Association of Southeast Asian Nations during his talk with leaders of the business community. The foreign minister suggested that if necessary, Japan must "sacrifice" its own interests for the benefit of encouraging economic growth in the region. Japanese relations with ASEAN (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) have been under some strain in recent years due largely to the pattern of trade between them. ASEAN claims that Japan's imports from the region, despite heavy purchases of oil and liquefied gases, are dropping overall, and that raw materials make up the bulk of imports rather than processed agricultural products and manufactured goods of greater value.

Indeed, preliminary figures for 1985 indicate that two-way trade between Japan and ASEAN dipped by about 13 percent compared to the year before, totaling a little over $31 billion, down from 1984's $36.2 billion (see Table). In the process, though, Japan's overall trade deficit with the group grew from $7.9 billion to $8.8 billion-plus as exports dropped by 20 percent while imports declined by only 9 percent.

In bilateral terms, only oil-rich Brunei bought more Japanese goods in 1985. Exports to the other countries dropped between 12 percent and 29 percent, with Indonesia and Malaysia recording the largest cuts in purchases. Growth in both nations has been sluggish over the past several years as a result of the downturn in world petroleum prices, a slowdown in agricultural production and strict government economic policies. For different reasons, Singapore, Thailand and the Philippines have also been suffering through tough economic times, a fact reflected in Japan's smaller shipments to them.

Conversely, falling oil prices plus a big drop in the volume of crude bought from Indonesia (see article in this issue) help explain the drop in the import column. So do lower prices for the other industrial and agricultural inputs Japan buys from the six nations. In fact, Japan's purchases from ASEAN dipped in every instance. Japanese officials rightly expect renewed criticism from the group due to this development.

In light of Mr. Abe's announcement, the Foreign Ministry has indicated that its new foreign policy emphasis will require a review of Japan's foreign aid policies. One high-level advisory panel has already submitted recommendations for aid policy reform to the foreign minister (see JEI Report No. 1B, January 10, 1986). A ministry official has indicated that a study group on Japan-ASEAN relations will be established, which would, among other things, make recommendations on how to improve Japan-ASEAN trade relations in time for a meeting of ASEAN foreign ministers and ASEAN Dialogue partners scheduled for June.

The same official told newsmen that Japan's new aid policy will take a more "general" approach and focus on "non-project" aid, including Indonesia's agriculture development program and Thailand's east coast industrial development plans. The increased use of commodity loans is also reportedly under discussion. Finally, Japan intends to expand its use of international agencies to help target and distribute assistance.

Sheri Hoptman

Japan's Trade with ASEAN, 1980-85

(in millions of dollars; exports f.o.b., imports c.i.f.)

	1980	1981	1982	1983	1984	1985
Brunei						
Exports	$ 88	$ 93	$ 145	$ 86	$ 72	$ 81*
Imports	3,245	2,907	2,636	2,367	2,202	1,727*
Trade Balance	-3,156	-2,814	-2,491	-2,281	-2,131	-1,646*
Indonesia						
Exports	3,458	4,123	4,261	3,552	3,073	2,170
Imports	13,167	13,305	12,005	10,432	11,175	10,117
Trade Balance	-9,709	-9,182	-7,744	-6,880	-8,102	-7,947
Malaysia						
Exports	2,061	2,424	2,502	2,771	2,875	2,167
Imports	3,471	2,927	3,010	3,131	4,412	4,309
Trade Balance	-1,410	-503	-508	-360	-1,537	-2,142
Philippines						
Exports	1,683	1,928	1,802	1,744	1,080	952
Imports	1,951	1,731	1,576	1,306	1,419	1,242
Trade Balance	-268	197	227	437	-338	-290
Singapore						
Exports	3,911	4,468	4,373	4,448	4,610	3,860
Imports	1,507	1,944	1,826	1,468	1,775	1,594
Trade Balance	2,404	2,524	2,547	2,981	2,835	2,266
Thailand						
Exports	1,917	2,251	1,907	2,506	2,425	2,030
Imports	1,119	1,061	1,041	1,019	1,040	1,027
Trade Balance	797	1,189	966	1,488	1,385	1,003
Total ASEAN						
Exports	13,118	15,287	14,990	15,107	14,134	11,260
Imports	24,461	23,876	22,094	19,722	22,024	20,016
Trade Balance	-11,343	-8,589	-7,103	-4,615	-7,887	-8,756

*Data for Brunei are for eleven months.

Source: Japan Tariff Association